United States Court of Appeals

for the Second Circuit

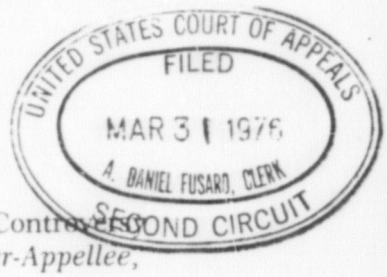
APPELLANT'S REPLY BRIEF

75-7614

IN THE

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT



No. 75-7614

In the Matter of the Arbitration of a Contro[illegible]
Between KNIT-AWAY, INC., *Petitioner-Appellee*,

AND

I. W. FOSTER SPORTSWEAR CO., INC., *Respondent-Appellant*

REPLY BRIEF FOR RESPONDENT-APPELLANT

On Appeal from the Decision of the United States District Court for Southern District of New York, 75 Civ. 2354, on October 24, 1975.

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I. Pennsylvania Law, Rather Than New York Law, Governs the Question Whether Foster Accepted Knit-Away's Offer to Agree to Arbitrate.

Since the federal courts, in cases where jurisdiction is based on diversity of citizenship only, apply the conflict of law rule of the forum state, *Klaxon Co. v. Stentor Electric Mfg. Co.*, 313 U.S. 487, 61 S.Ct. 1020 (1941), the New York conflict of laws rule is controlling.

The New York conflict of laws rule in contract cases is that the court should apply the law of the state "which has the most significant contacts with the matter in dispute." *Haag v. Barnes*, 9 N.Y. 2d 554, 175 N.E. 2d 441, 216 N.Y.S. 2d 65, 87 A.L.R. 2d 1301 (1961); *Auten v. Auten*, 308 N.Y. 150, 155, 124 N.E. 2d 99, 101, 50 A.L.R. 2d 246 (1954). This is the rule that has been adopted by Restatement of Conflict of Laws §188.

According to Restatement of Conflict of Laws §188:

> Law Governing in Absence of Effective Choice by the Parties
>
> (1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, *with respect to that issue*, has the most significant relationship to the transaction and the parties under the principles stated in §6.
>
> (2) In the absence of an effective choice of law by the parties (see §187), the contacts to be taken into account in applying the principles of §6 to determine the law applicable to an issue include (a) the place of contracting, (b) the place of negotiation of the contract, (c) the place of performance, (d) the location of the subject matter of the contract, and (e) the domicil, residence, nationality, place of incorporation and place of business of the parties. *These contacts are to be evaluated according to their relative importance with respect to the particular issue.*

(3) If the place of negotiating the contract and the place of performance are in the same state, the local law of this state will usually be applied, except as otherwise provided in §§189-199 and 203. [Emphasis added]

A brief summary of the facts pertinent to the application of the "most significant contacts" test is as follows:

1. Foster is a Pennsylvania corporation, and its principal office and principal place of business are in Pennsylvania (13a, 32a, 43a, 45a, 46a, 85a, 90a, 91a, 92a, 94a, 97a).

2. Knit-Away is a North Carolina corporation (5a), and its principal office and principal place of business are at Raeford, North Carolina (13a-32a, 46a-85a).

3. In August, 1974, Foster orally placed an order with Knit-Away and Knit-Away orally accepted Foster's order (A. 123a-124a). The record does not indicate either where or in what manner this order was orally placed or where or in what manner it was orally accepted.

4. Between September 19, 1974 and February 17, 1975, Knit-Away's head office in North Carolina mailed twenty shipment advices to Foster in Pennsylvania (13a-32a). Knit-Away contends that these shipment advices were order confirmations, and that, under U.C.C. §§201(2) and 2-207(2), Foster "accepted" the arbitration clause on the reverse side thereof by silence, by failing to communicate objections thereto to Knit-Away. If there was an "acceptance" of the arbitration clause, however, the acceptance and any resulting agreement occurred in Pennsylvania, since that is where Foster's "silence" occurred.

5. Between October 15, 1974 and February 10, 1975, a larger number of invoices, of which 40 are unpaid (46a-85a), were mailed from Knit-Away in North Carolina to Foster in Pennsylvania.

6. Of the 40 unpaid invoices set forth in the Appendix, 30 identify Foster's Pennsylvania plant as the destination of the goods, 5 identify Foster's Tennessee plant as the destination, and 5 leave the destination for future decision.

7. Although Foster has a branch office in New York (5a, 6a, 97a), there is nothing in the record to indicate that any act or omission by Foster pertinent to the instant dispute ever occurred in New York.

8. There is nothing in the record to indicate that any act or omission by Knit-Away pertinent to the instant dispute ever occurred in New York.[1]

9. The arbitration clause on the reverse side of the shipment advices materially alters the antecedent oral agreement by stating that disputes shall be settled by arbitration in the City of New York. However, the record indisputedly establishes that Foster never saw this clause (124a). Howard Foster's affidavit (124a) states, without contradiction, that:

> The inclusion by Foster in small print on the reverse side of its shipping invoices of a statement concerning arbitration was done unilaterally by Knit-Away, without Foster's knowledge or agreement.

From the foregoing circumstances, it is obvious that Pennsylvania is the state which, with respect to the issue whether the parties agreed to arbitrate, "has the most significant relationship to the transaction and the parties" within the meaning of Restatement of Conflict of Laws §188(2). The following analysis will demonstrate not only that Pennsylvania has more contacts with the transaction and the parties than any other state, but also that Pennsylvania's contacts are the most significant when (as is required by Restatement of Conflict of Laws) they "are . . . evaluated according to their relative importance with respect to the particular issue":

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1. Although Knit-Away's Petition (5) alleged that it had a branch office in New York, this allegation was denied on the ground of lack of knowledge or information sufficient to form a belief (97a). Therefore, it has not been established that Knit-Away had any branch office in New York.

1. *The place of contracting*

Pennsylvania alone has this contact, since the last act or omission which created the alleged agreement to arbitrate, viz., Foster's silence following receipt of the alleged written confirmations, occurred in Pennsylvania. See *Tuition Plan Inc. v. Zicari*, 335 N.Y.S. 2d 95, 101-102, 70 Misc. 2d 918 (Dist. Ct., Suffolk County Second District 1972), in which the Court said:

> Where part of an agreement is executed in one jurisdiction and the rest of it, constituting the final act to make it complete, is executed in another jurisdiction, the law of the latter controls.

2. *The place of negotiation of the alleged agreement to arbitrate.*

The proposed agreement to arbitrate was not mentioned until the first alleged confirmations containing the arbitration clause were mailed by Knit-Away to Foster. Accordingly, the only negotiations pertinent to the alleged agreement occurred in Pennsylvania, the state to which the alleged "confirmations" containing the arbitration clause were mailed, and North Carolina, the state from which the said documents were mailed.[2]

3. *The place of performance.*

There is no place of performance since there was no agreement to arbitrate. Had there been an agreement to arbitrate pursuant to the arbitration clause relied upon by Knit-Away, the place of arbitration would have been New York unless this court or the arbitration tribunal determined that the arbitration should take place elsewhere.

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2. Nothing was said about arbitration in the conversation in which the original oral order was orally placed and was orally accepted (124a).

4. *The location of the subject matter of the contract.*

Since most of the goods were to be made in North Carolina and shipped from North Carolina to Pennsylvania, the "location of the subject matter of the contract" was in Pennsylvania and North Carolina.

5. *The place of incorporation of the parties.*

The places of incorporation were Pennsylvania (as to Foster) and North Carolina (as to Knit-Away).

6. *The domicil, residence and place of business of the parties.*

These were Pennsylvania and North Carolina, since Foster had its principal office and its principal plant in Pennsylvania, and Knit-Away had its principal office and plant in North Carolina.

Summing up:

Pennsylvania was: (1) the only place of the alleged contracting; (2) one of the places of negotiation of the contract; (3) one of the places where the subject matter of the contract was located; (4) the state of incorporation of one of the two parties to the contract; and (5) the domicil, residence and principal place of business of one of the two parties to the contract. North Carolina qualified as to Factors 2, 4, 5 and 6, but not Factor 1. New York did not in any way qualify as to Factors 1, 2, 4, 5 and 6.

Thus, Pennsylvania had six contacts, North Carolina had five contacts, and New York had one contact with the matter in dispute. Furthermore, New York's sole contact with the matter in dispute is relatively unimportant from the standpoint of the matter in issue. The issue to be decided is whether the parties agreed to arbitrate. From the standpoint of that issue, the most important contacts of all are the place where the agreement to arbitrate was allegedly entered into (Pennsylvania), the place where it was negotiated (Pennsylvania and North Carolina), the

place of the principal place of business of the party against whom the agreement is sought to be enforced (Pennsylvania), and the place of incorporation of that party (Pennsylvania). The least important contact is the place of performance of that agreement (New York, if the Court or arbitration tribunal does not rule otherwise).

When, as here, the issue is whether a seller of merchandise succeeded in imposing an arbitration clause upon the buyer by including it in the fine print verbiage on the back of various shipment advices, the seller would indeed be lifting itself by the bootstraps if the place of arbitration designated in the arbitration clause were deemed to have any important bearing upon the choice of the law governing the question whether the recipient of the shipment advices should be deemed to have impliedly agreed to the arbitration clause by failing to express any objection thereto.

It will be recalled that Restatement of Conflict of Laws §188(1) states that the law governing an issue relating to a contract is the local law of "the state which, with respect to this issue, has the most significant relationship to the transaction"; and that, after enumerating various contacts, §188(2) states that these contacts "are to be evaluated according to their relative importance with respect to the particular issue". Applying the New York conflict of laws rule set forth in *Auten v. Auten, supra*, to a contract case where the issue was where the parties had entered into the alleged contract, this Court has specifically held that the place of performance is a relatively insignificant contact, and that such contacts as the principal office, residence and place of incorporation of the parties, the place of the alleged agreement and the place of negotiation of the alleged agreement "are more important . . . especially so when the issue is whether [the parties] made any contract . . . at all". *Kirtley v. Abrams*, 299 F.2d 341, 345, fn. 6 (2 Cir. 1962).

The *Kirtley* case is squarely in point. There, as in the case at bar, the issue is whether the agreement sought to be enforced was entered into at all.

Also, the contacts which the Court in the *Kirtley* case deemed particularly important in relationship to that issue are all contacts which, in the case at bar, Pennsylvania has, and New York does not have. These contacts, which Pennsylvania has and New York does not have, are those identified as Factors 1, 2, 5 and 6. Pennsylvania is the place where the alleged agreement was allegedly entered into, where it was negotiated, where the party sought to be bound (Foster) has its principal office, and where that party was incorporated. New York's only contact, viz., the fact that it is the place where the arbitration clause stated arbitration should take place, is the very type of contact which this Court, in *Kirtley*, ruled is relatively unimportant when the issue is whether the parties entered into the alleged agreement at all.

For all of the above reasons, Pennsylvania law applies to the issue whether the parties agreed to arbitrate.

Knit-Away's contention that Foster "agreed" that New York law would apply is erroneous and untrue. At no time did Foster so agree. An examination of the briefs filed in the court below will confirm this fact.

In fact, neither in its initial memorandum nor in its reply memorandum, did Knit-Away ever even contend that New York law applied. Certainly, the mere fact that Knit-Away cited New York cases in these memoranda did not constitute such a contention. Nor does the fact that Foster discussed New York cases in its answering memorandum, in order to negative Knit-Away's arguments with respect to the New York cases cited by Knit-Away, constitute an agreement by Foster that New York law applied. It was quite natural for Foster to endeavor in this manner to discredit Knit-Away's arguments. Particularly in view of the fact that Knit-Away had never contended that New York law applied, this did not constitute an agreement that New York law did apply.

II. Assuming That Pennsylvania Law Applies, Knit-Away's Arguments on the Merits Are Fully Met by Foster's Appellant's Brief.

In our Appellant's Brief, we have at length demonstrated that, under Pennsylvania law, the arbitration clause relied upon by Knit-Away is not binding upon Foster. Knit-Away has expressly refrained from discussing the law of jurisdictions other than New York. See page 16 of Knit-Away's Appellee's Brief. Therefore, further discussion as to Pennsylvania law on the subject is not needed.

III. Had New York Law Been Applicable, U.C.C. §2-207(2)(b) Would Have Required a Holding That the Arbitration Clause Was a "Material Alteration" of the Prior Oral Agreement or Order and Therefore Precluded Foster's Silence From Causing Foster to Be Bound by the Arbitration Clause.

In *Application of Doughboy Industries, Inc.*, 17 A.D. (2d) 216, 495-496, 233 N.Y.S. 2d 488 (1st Dept. 1962), the First Department of the Appellate Division of the New York Supreme Court expressly and specifically held that an arbitration clause in a seller's written confirmation of a prior oral or agreement for the purchase of merchandise is "a material alteration" of the oral order or agreement within the meaning of U.C.C. §2-207(2)(b), and, therefore, that U.C.C. §2-207(2)(b) prevented the buyer's failure to object thereto within a reasonable time from causing the arbitration clause to become binding.

In *Doughboy*, the Court quoted with approval the following comments by the draftsmen of U.C.C. §2-207 concerning that Section and stated that these comments "are in precise point":

> 3. Whether ot not additional terms will become part of the agreement depends upon the provisions of subsection (2). If they are such as to materially alter the original bargain, they will not be included unless ex-

> pressly agreed to by the other party. If, however, they are terms which would not so change the bargain they will be incorporated unless notice of objection has already been given or is given within a reasonable time.

Applying these principles to the arbitration clause set forth in the seller's written confirmation involved in that case, the Court in that case said (17 A.D. 2nd at 84):

> On this exposition the arbitration clause, whether viewed as a material alteration under subsection (2) or as a term nullified by the conflicting provision in the buyer's form, would fail to survive as a contract term. In the light of the New York cases, at least, there can be little question that an agreement to arbitrate is a material term, one not to be injected by implication, subtlety or inveiglement.

The Court's decision in *Doughboy* has never been overruled. There have been no Court of Appeals decisions on the subject, and four Appellate Division decisions concerning arbitration clauses in written confirmations which have been decided since then (the *Trafalgar*, *Braten*, *Loudon* and *Suits Galore* decisions[3]) have neither applied nor referred either to U.C.C. §2-207(2)(b) or to U.C.C. §2-207. It is not credible that the Court in these cases would have overruled the *Doughboy* decision concerning U.C.C. §2-207 (2)(b) without referring either to it or even to §2-207.

Moreover, it is not credible that the Court in any of the said four cases would have converted the exception to the statute of frauds set forth in U.C.C. §2-201(2) into a substantive provision covering the same territory as, and conflicting with, U.C.C. §2-207, without expressly stating that the Court so intended. In this connection, it should be noted that §2-201(2) is not mentioned in *Suits Galore* or *Braten*; that it is merely cited, and not construed in *Loudon*; and that *Trafalgar* merely applied it as an exception to the statute of frauds.

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3. These cases were cited at pp. 18 and 20 of Knit-Away's Brief.

Evidently, the Court in each of these cases held that the Statute of Frauds (U.C.C. §2-201(1)) was rendered inapplicable by U.C.C. §2-201(2), and then proceeded to hold that the buyer's silence caused him to be bound without considering or construing §2-207(2).

The interpretation of §2-201(2) which Knit-Away claims was impliedly given to §2-201(2) by *Trafalgar*, *Bratten*, *Loudon* and *Suits Galore* would so twist the language of §2 207 (which itself completely covers the field relative to the effect of a failure to object to a written confirmation) that an intention to adopt such an interpretation should not be attributed to the Court in the said cases absent clear and unequivocal language adopting such an interpretation. Since none of these cases expressly construed §2-201(2) in the manner contended by Knit-Away, they should be deemed not to have adopted by implication any such interpretation of §2-201(2).

Moreover, if they had thus construed §2-201(2), this would not constitute an overruling of the *Doughboy* interpretations of §2-207(2)(b), in view of the fact that the latter provision was not referred to in those cases.

In passing, it should be noted that, since §2-207(2)(b) deals only with terms in written confirmations which constitute "material alterations", §2-207(2)(b) would be a more specific provision than §2-201(2) even were §2-201(2) erroneously given substantive significance. It is axiomatic that, in case of conflict, a more specific statute prevails over a more general statute.

IV. Foster Had the Right to Withdraw Its Demand for Arbitration at any Time Before the Said Demand Was Accepted by Knit-Away.

Foster's demand to arbitrate was at best a mere offer to arbitrate which was revocable at any time before it was accepted. *Ford Motor Company Ltd. v. M/S Maria Gorthon*, 397 F. Supp. 1332, 1336 (D. Md. 1975). Since Knit-Away had not yet accepted this offer when the offer was withdrawn by Foster, Foster had the right to withdraw it.

Calvine Mills, Inc. v. L. A. Slesinger, Inc., 258 F.2d 228 (2d Cir. 1958) is not in point. In that case, the parties had admittedly agreed that the seller had an option to insist on arbitration. An option is a continuing offer and, therefore, the Court held that the seller's demand for arbitration constituted a binding acceptance of the said continuing offer.[4] Once an offer has been accepted while it is still in effect, it, of course, cannot be withdrawn.

In the case at bar, however, the offers to agree to arbitrate which Knit-Away sought to make when it mailed the written confirmations to Foster would have expired after "a reasonable time" even if they had been so conspicuous that Foster had reason to know of them.[5] However, as is stated in Restatement of Contracts §40(1),

> . . . the power to create a contract by acceptance of an offer terminates at the time specified in the offer, or if no time is specified, at the end of a reasonable time.

Certainly, more than a "reasonable time" for accepting the offer to agree to the arbitration clause had elapsed by the time when the demand for arbitration was served. Therefore, Knit-Away's offer to agree to the arbitration clause had expired before the demand for arbitration was served; and Foster's demand for arbitration was itself a mere offer to arbitrate which was effectively revoked before it was accepted.

A second reason why Foster's demand for arbitration did not create an agreement to arbitrate the specific dis-

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4. As said by this Court in *Fisser v. International Bank*, 282 F.2d 231, 234 (2d Cir. 1960):

> . . . an optionee by exercising an option may create a mutually binding contract to arbitrate. Calvine Mills, Inc. v. L. A. Slesinger, Inc., 2d Cir. 258 F.2d 288.

5. Actually, Knit-Away's offer to agree upon the arbitration clause was never validly communicated to Foster, since it was so inconspicuous that Foster did not have reason to know of it. For convenience of discussion, however, it will be assumed *arguendo*, in this section, that it was an "offer."

pute described in the demand is that the attempted offer implicit in the arbitration clause in the shipment advices was an offer to agree upon the arbitration clause, not an offer to agree to arbitrate a specific existing dispute. Therefore, it was not capable of acceptance by a demand to arbitrate a specific existing dispute. Since there was no agreement to arbitrate, the Court below had no jurisdiction to compel Foster to arbitrate, since the Federal Arbitration Act merely authorizes the District Courts to enforce agreements to arbitrate. See 9 U.S.C. §§2, 3, 4.

For all of these reasons, the demand for arbitration which Foster made and withdrew is irrelevant.

It should be noted further that with respect to the demand for arbitration, Howard S. Foster averred in paragraph 8 of his affidavit (A. 126a) that:

> This demand was not based upon any binding and enforceable agreement to arbitrate between Knit-Away and Foster. Rather Foster's demand for arbitration was based on its belief formed pursuant to Mr. McDonald's offers, that Knit-Away would voluntarily enter into arbitration pursuant to Foster's demand.

No facts are averred in any of Knit-Away's affidavits which controvert or disprove these averments.

These averments should be read, moreover, in the light of the following undisputed averments in paragraph 4 of Howard S. Foster's affidavit (124a)

> There was no discussion of arbitration at the time of the August, 1974 agreement. No agreement to arbitrate with Knit-Away has ever been entered into by Foster, either orally or in writing. The inclusion by Foster in small print on the reverse of its shipping invoices of a statement concerning arbitration was done unilaterally by Knit-Away without Foster's knowledge or agreement.

For all of the above reasons, the demand for arbitration, which Foster made on April 23, 1975 and revoked on May 2, 1975, was a mere revocable offer by Foster to arbitrate the dispute between it and Knit-Away, which offer was validly revoked by Foster before it had been accepted by Knit-Away.

V. Knit-Away's Prayer for Counsel Fees, Double Costs and Disbursements Is Itself Frivolous.

We have demonstrated herein, *inter alia*: (a) that Pennsylvania law applies; (b) that, under §2-207(2)(b) of the Pennsylvania Uniform Commercial Code, the arbitration clause was a "material alteration" and, therefore, was not accepted by mere silence; (c) that the twenty shipment advices were not "a written confirmation which is sent within a reasonable time", as is also required by U.C.C. §2-207(2); and (d) that Foster's demand for arbitration was a mere revocable offer to arbitrate, which was revoked before it was accepted by Knit-Away.

In view of the foregoing, Foster is entitled to a reversal of the decision below. If, however, the decision below is affirmed, Foster's claim for counsel fees, double costs and disbursements should be denied, since, clearly, this appeal was not frivolous, but has been made in good faith and on the basis of substantial and convincing precedents.

Respectfully submitted,

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